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No. 543

In the Supreme Court of the United States

OCTOBER TERM, 1959

THE PHILADELPHIA SAVING FUND SOCIETY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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OPINIONS BELOW

The opinion of the Court of Appeals (Pet. 7a–14a) is reported at 269 F. 2d 853. The opinion of the District Court (Pet. 1a–5a) is reported at 167 F. Supp. 814.

JURISDICTION

The judgment of the Court of Appeals was entered on July 20, 1959 (Pet. 15a). A timely petition for rehearing was denied on September 22, 1959. The petition for a writ of certiorari was filed on November 25, 1959. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether a Federal Deposit Insurance Corporation credit received by taxpayer, a mutual savings bank, during the year 1952 constituted taxable income for that year.

STATUTES, REGULATIONS, AND RULINGS INVOLVED

Section 7 (a), (d), and (e) of the Federal Deposit Insurance Act; Section 22(b)(12) of the Internal Revenue Code of 1939; Section 39.22(b)(12)–1 of Treasury Regulations 118; and Rev. Rul. 55–478 are set forth in the Appendix, *infra*, pp. 10–13.

STATEMENT

This case concerns the inclusion in gross income of the taxpayer for the year 1952 of a sum which accrued to it in that year as a credit from the Federal Deposit Insurance Corporation. The facts, which are not in dispute, are as follows:

The taxpayer is a mutual savings bank whose deposits are insured under the Federal Deposit Insurance Act (64 Stat. 873, 12 U.S.C. 1811, *et seq.*). It files its income tax returns and keeps its books on the accrual basis. Under Section 7(a) of the Act, the taxpayer must pay to the Federal Deposit Insurance Corporation each year an assessment at the rate of one-twelfth of one percent of its deposit liability. Section 7(d) of the Act requires that from assessments received from insured banks the FDIC must pay (1) its operating costs and expenses for the calendar year, (2) additions to reserve to provide for insurance losses during the calendar year, and (3) the insurance losses sustained in the calendar year

plus losses from any preceding years in excess of reserves. The balance remaining to the FDIC from the assessments is termed the "net assessment income", sixty percent of which must be credited pro rata (on the basis of that year's assessments) to each insured bank after the close of the year. In 1952 there accrued to the taxpayer in this manner a credit in the amount of $281,782.05. (Pet. 1a.)

On its federal income tax return for the year 1952, the first year for which the taxpayer became subject to the tax,[1] it deducted $523,949.72 as an ordinary and necessary business expense, being the sum of the two deposit-insurance assessments for that calendar year. (R. 6a.)[2] The taxpayer did not include in its gross income for the year 1952 the amount of $281,782.05 representing the credit which it received on June 20, 1952, nor did it reduce its expense deduction of $523,949.72 by the amount of the credit which was applied against that expense. (R. 5a, 6a, 10a.)

The Commissioner of Internal Revenue determined that the credit of $281,782.05 was taxable income for the year 1952. (R. 4a, 5a, 6a, 10a–11a.) Taxpayer paid the additional tax and then brought this suit for refund. (R. 4a, 5a, 6a, 10a–11a.) On motions filed by both parties for judgment on the pleadings or for summary judgment (Pet. 1a), the District Court entered judgment for the United States (Pet. 6a).

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[1] The taxpayer was previously exempt under Section 101(2) of the Internal Revenue Code of 1939, which was repealed by Section 313(a), Revenue Act of 1951, 65 Stat. 452.

[2] "R." refers to the taxpayer's appendix in the Court of Appeals.

The Court of Appeals, by a divided court, affirmed (Pet. 7a–14a).

ARGUMENT

The situation presented by this case is a narrow one which in its nature probably will never recur subsequent to the taxable year here involved. It does not present a question of general importance, the decisions below are correct, and there is no conflict of decisions. There appears to be no occasion for further review.

The sole question is whether a FDIC credit in the amount of $281,782.05, which accrued to the account of taxpayer on June 20, 1952, constitutes taxable income to the taxpayer during that year. The taxpayer's entire argument is predicated upon its allegation that the 1952 credit represents the recovery of an overpayment of deposit-insurance assessments in 1951. Since the taxpayer was exempt from income taxation in 1951,[3] its deduction of the assessments when paid gave it no tax benefit. Hence it claims that its "recovery" of the overpayments in 1952 should not, under the "tax-benefit" rule, be taxable to it. In our view, however, there are at least two reasons why the tax benefit rule is not applicable. The first is that the FDIC credit does not represent the recovery of an overpayment by taxpayer of any particular deposit-insurance assessment; the second is that the tax benefit rule does not apply where the reason that no tax benefit was received was that the taxpayer was completely exempt from taxation during the earlier year.

[3] See note 1, *supra*.

1. There is no dispute that the credit is within the broad definition of "gross income" of Section 22(a) of the 1939 Code (see *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426) unless it is excludable by virtue of the tax benefit rule. Section 22(b)(12) (*infra*, p. 11) grants an exclusion for the "recovery" during the taxable year of a bad debt or a tax for which a deduction was "allowed" in a prior year if that deduction "did not result in a reduction of the taxpayer's tax under this chapter". Under the Treasury Regulations, that rule is not limited to the items specifically enumerated (bad debts and taxes) but applies as well "to all other losses, expenditures, and accruals made the basis of deductions from gross income for prior taxable years." Regulations 118, Section 39.22(b)(12)–1 (*infra*, p. 12). The Commissioner has ruled specifically, however, that the exclusion does not apply to FDIC credits and that such credits constitute income in the year received or accrued. Rev. Rul. 55–478, 1955–2 Cum. Bull. 18 (*infra*, p. 13); see also Rev. Rul. 62, 1953–1 Cum. Bull. 71. That ruling is clearly correct, for the FDIC credit represents, not a "recovery" of a particular prior payment,* but essentially a dividend of FDIC income.

* The limitation of Section 22(b)(12) and the regulations to recoveries of identifiable prior-year payments or losses simply codifies the established requirement of the tax benefit rule that there must be such an interrelationship between the event which constitutes the loss or expenditure and the event which constitutes the recovery that they can be considered as part of the same transaction. *Waynesboro Knitting Co.* v. *Commissioner*, 23 T.C. 404, affirmed, 225 F. 2d 477, 480 (C.A. 3); *Farr* v. *Commissioner*, 11 T.C. 552, affirmed, *sub nom. Sloane* v. *Com-*

The Federal Deposit Insurance Act (*infra*, p. 10) provides that member banks are to be assessed at the rate of one-twelfth of one percent per annum of their "deposit liability" (§ 7(a)). The assessments less operating costs, additions to reserve, and insurance losses constitute the "net assessment income" of the FDIC (§ 7(d)). The Act provides that during each year the FDIC shall transfer forty percent of its net assessment income to its capital account, and the balance of its net assessment income is to "be credited pro rata to the insured banks based upon the assessments of each bank becoming due" during the calendar year in question (§ 7(d)). By its terms, the Act makes clear that it is the income of the FDIC which is being credited to the member banks ("the Corporation shall transfer 40 per centum of its net assessment income"), rather than a refund of an overpayment to the members of their earlier expenditures.[5] In sharp contrast to those provisions is the express provision for refunds of actual overpayments of assessments. Section 7(e) provides that the FDIC—

> (1) may refund * * * any payment of assessment in excess of the amount due to the Corporation or (2) may credit such excess toward

missioner, 188 F. 2d 254, 262–263 (C.A. 6); *Allen* v. *Trust Co. of Georgia*, 180 F. 2d 527 (C.A. 5), certiorari denied, 340 U.S. 814.

[5] That interpretation accords with the legislative history. See Hearings before a Subcommittee of the Senate Committee on Banking and Currency, Bills to Amend the Federal Deposit Insurance Act, 81st Cong., 2d Sess.; S. Rep. No. 1269, 81st Cong., 2d Sess.; H. Rep. No. 2564, 81st Cong., 2d Sess.; 96 Cong. Rec. 10648–10671.

> the payment of the assessment next becoming due from such bank * * *.

A Section 7(e) refund or credit of an overpayment clearly constitutes a "recovery" of a prior expenditure within the meaning of the tax benefit rule and, by contrast, emphasizes the different nature of the Section 7(d) income credit. Section 7(d) provides, not for a "refund" of prior payments, but simply for the equitable distribution of the FDIC's excessive assessment income.[8]

2. Even should it be assumed for the purposes of argument that the 1952 credit constituted a recovery of a portion of the taxpayer's 1951 deposit insurance assessments, it is the position of the Government that the tax benefit rule, as codified in Section 22(b)(12) of the 1939 Code and the regulations, would nevertheless not apply. The only reason that the 1951 assessments did not result in a reduction of taxpayer's income tax in 1951 is that prior to 1952 the taxpayer was entirely exempt from income taxation. Thus, the taxpayer, in effect, is arguing that the credit which it admittedly received in 1952, and which, under the fixed annual accounting principle (see *Burnet* v. *Sanford & Brooks Co.*, 282 U.S. 359) is income for

[8] *Penn Mutual Life Ins. Co.* v. *Lederer*, 252 U.S. 523, held that under the express provisions of the Revenue Act of 1913 dividends paid out by a mutual insurance company were not deductible from its premium income. In what way that decision is thought to conflict with the decision below (Pet. 10–13) is not apparent, and nothing in the Court's introductory description of the operation of a mutual company quoted by petitioner (Pet. 11) touches on the issue here—the characterization of the FDIC credit *for purposes of the tax benefit rule.*

that year, cannot be treated as income since prior to 1952 Congress had not seen fit to tax its income. It is apparent, however, that the exclusion of the 1952 credit from taxpayer's gross income for that year, while at the same time allowing a full deduction for its 1952 assessment against which the credit was applied, would distort its income for the first year it is subject to tax. That result, we think, is not required by the essentially equitable purposes underlying the tax benefit rule.

The tax benefit rule had its origin in cases involving the recovery of bad debts. Under fixed annual accounting principles, the recovery on a bad debt or capital loss in a tax year subsequent to that in which the debt was charged off or the loss incurred is income in the year of recovery since, for tax purposes, one looks only to the result of the transaction in the subsequent year which is the unit of taxation. This was held to be true irrespective of whether the prior charge-off and deduction for the loss resulted in any tax benefit in the prior year.[7] It was to relieve in part such hardships arising from the annual accounting system that the tax benefit rule was evolved. No such hardship is involved, however, where the lack of a tax benefit in the prior year is due solely to the fact that the taxpayer was then totally exempt from taxation. In such a case, the taxpayer has not lost the benefit of a specific deduction to which it was otherwise entitled; it has, to the contrary, simply been the

[7] *Commissioner* v. *United States & International Securities Corp.*, 130 F. 2d 894, 897 (C.A. 3); *Helvering* v. *State-Planters Bank & Trust Co.*, 130 F. 2d 44, 46–47 (C.A. 4).

recipient of an even greater benefit—to wit, total exemption from the tax. Thus, there has been no loss of a tax advantage to be compensated for by allowing an exclusion in the later year.

3. The short answer to petitioner's claim of a conflict on the scope of the "clearly erroneous" rule (Pet. 5–10) is that the decision below did not rest on that ground. Although the Court of Appeals used that formulation to some extent in stating its ultimate conclusion, it is evident from its opinion that it viewed the question as one of law and independently arrived at the same result as had the Commissioner and the District Court.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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DECEMBER 1959.

APPENDIX

1. Federal Deposit Insurance Act § 7, 64 Stat. 876, 12 U.S.C. 1817:

> SEC. 7. (a) The assessment rate shall be one-twelfth of 1 per centum per annum. * * *
>
> * * * * * *
>
> (d) As of December 31, 1950, and as of December 31, of each calendar year thereafter, the Corporation shall transfer 40 per centum of its net assessment income to its capital account and the balance of the net assessment income shall be credited pro rata to the insured banks based upon the assessments of each bank becoming due during said calendar year. Each year such credit shall be applied by the Corporation toward the payment of the total assessment becoming due for the semi-annual assessment period beginning the next ensuing July 1 and any excess credit shall be applied upon the assessment next becoming due. The term "net assessment income" as used herein means the total assessments which become due during the calendar year less (1) the operating costs and expenses of the Corporation for the calendar year; (2) additions to reserve to provide for insurance losses during the calendar year, except that any adjustments to reserve which result in a reduction of such reserve shall be added; and (3) the insurance losses sustained in said calendar year plus losses from any preceding years in excess of such reserves. If the above deductions exceed in amount the total assessments which become due during the calendar year, the amount of such excess shall be restored by deduction from total assessments becoming due in subsequent years.

(e) The Corporation (1) may refund to an insured bank any payment of assessment in excess of the amount due to the Corporation or (2) may credit such excess toward the payment of the assessment next becoming due from such bank and upon succeeding assessments until the credit is exhausted.

* * * * *

2. Internal Revenue Code of 1939 (26 U.S.C., 1952 ed.):

SEC. 22. * * *

* * * * *

(b) *Exclusions from Gross Income.*—The following items shall not be included in gross income and shall be exempt from taxation under this chapter:

* * * * *

(12) *Recovery of bad debts, prior taxes, and delinquency amounts.*—Income attributable to the recovery during the taxable year of a bad debt, prior tax, or delinquency amount, to the extent of the amount of the recovery exclusion with respect to such debt, tax, or amount. For the purposes of this paragraph:

(A) *Definition of Bad Debt.*—The term "bad debt" means a debt on account of worthlessness or partial worthlessness of which a deduction was allowed for a prior taxable year.

(B) *Definition of Prior Tax.*—The term "prior tax" means a tax on account of which a deduction or credit was allowed for a prior taxable year.

(C) *Definition of Delinquency Amount.*—The term "delinquency amount" means an amount paid or accrued on account of which a deduction or credit was allowed for a prior taxable year and which is attributable to failure to file return with respect to a tax, or pay a tax, within the time required by the law under which the tax is imposed, or to failure to file return with respect to a tax or pay a tax.

(D) *Definition of Recovery Exclusion.*—The term "recovery exclusion", with respect to a bad debt, prior tax, or delinquency amount, means the amount, determined in accordance with regulations prescribed by the Commissioner with the approval of the Secretary, of the deductions or credits allowed, on account of such bad debt, prior tax, or delinquency amount, which did not result in a reduction of the taxpayer's tax under this chapter (not including the tax under section 102) or corresponding provisions of prior revenue laws, reduced by the amount excludible in previous taxable years with respect to such debt, tax, or amount under this paragraph.

* * * * *

3. Treasury Regulations 118:

SEC. 39.22(b)(12)-1. *Recovery of certain items previously deducted*—(a) *In general.* Section 22(b)(12) provides that income attributable to the recovery during any taxable year of bad debts, prior taxes, and delinquency amounts shall be excluded from gross income to the extent of the "recovery exclusion" with respect to such items. The rule of exclusion so prescribed by statute applies equally with respect to all other losses, expenditures, and accruals made the basis of deductions from gross income for prior taxable years, including war losses referred to in section 127, but not including deductions with respect to depreciation, depletion, amortization, or amortizable bond premiums. See *Dobson* v. *Commissioner*, 320 U.S. 489. The term "recovery exclusion" as used in this section means accordingly an amount equal to the portion of the bad debts, prior taxes, and delinquency amounts (the items specifically referred to in section 22(b)(12)), and of all other items subject to the rule of exclusion which, when deducted or credited for a prior taxable year, did not result in a reduction

of any tax of the taxpayer under chapter 1 of the Internal Revenue Code (other than a tax under section 102) or under corresponding provisions of prior revenue laws.

* * * * *

4. Rev. Rul. 55–478, 1955–2 Cum. Bull. 18:

In the case of mutual savings banks not having capital stock represented by shares, as in the case of other insured banks, Federal Deposit Insurance Corporation credits under section 7(d) of the Federal Deposit Insurance Act, 64 Stat. 873, at 877, 12 U.S.C. 1817(d), received or accrued in a taxable year beginning after December 31, 1951, constitute income for Federal income tax purposes, full deduction being allowable for the future assessments against which such credits are allowable. Such amounts received or accrued do not represent recoveries of any particular expenditures made in years beginning prior to December 31, 1951, during which such institutions were exempt from Federal income tax, but constitute gross income subject to tax in a taxable year in which received or accrued. Compare Rev. Rul. 62, C.B. 1953–1, 71 as made applicable by Rev. Rul. 214, C.B. 1953–2, 140.

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